

# Global Claims Consulting

Declaratory Judgment Expenses

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Guy Carpenter's Global Claims Consulting unit is dedicated to assisting clients with their difficult and complex reinsurance claims. We are greatly indebted to Mound Cotton Wollan & Greengrass for its considerable assistance in preparing this review and reference tool regarding declaratory judgment expenses. Contact information is available at [www.MoundCotton.com](http://www.MoundCotton.com).

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## Declaratory Judgment Expenses

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Legal expense incurred in defending or prosecuting a declaratory judgment action is often submitted to reinsurers for reimbursement. Although more recent and current reinsurance contracts specifically address whether or not declaratory judgment expenses are recoverable, disputes still arise under contracts that are silent and/or ambiguous on the issue and occur most frequently when dealing with a run-off market or in a direct placement scenario.

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### Definition

A declaratory judgment action is a lawsuit that is designed to adjudicate a dispute regarding an entity's rights or duties. Declaratory judgment actions are used to determine the parties' rights and obligations under a commercial contract (e.g., insurance policies), resolve issues regarding the ownership of real estate, rule on matrimonial status and determine the rights of beneficiaries under a trust agreement, as well as in a multitude of other situations.

A declaratory judgment action is commenced in the same manner, tried in the same manner and goes through the same pre-trial proceedings as a suit for monetary damages. In the context of an insurance policy, a declaratory judgment action can be filed either by the insured or the insurer, and we commonly see issues being addressed such as a determination of coverage, the function of a policy exclusion or whether an occurrence exists or not. Declaratory judgments are normally self-executing in that failure to comply with a declaratory judgment will almost surely be fatal to that party's interests in a subsequent suit for damages, should such a suit be necessary.

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### Declaratory Judgments and Associated Expenses

The term "declaratory judgment expenses" has become a euphemism for certain types of legal expenses incurred by the insurer. In the broadest sense, declaratory judgment expenses are the costs of legal activities to determine coverage. This would include not only those expenses incurred by the parties to a declaratory judgment action (e.g., legal fees, court costs, filing fees, witness fees, etc.), but also those legal fees and attendant expenses that arise prior to the filing of a declaratory judgment action or are incurred even though no declaratory judgment was filed (e.g., coverage counsel's fees for the research and drafting of an opinion letter). The scope of the term and whether such expenses are covered by reinsurance has been a hotly debated issue over the years.

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### A Cedent's Perspective

A cedent seeking recovery of declaratory judgment expenses may prefer the following definition of "reinsurance": "A contract by which an insurer procures a third party to insure him against loss or liability by reason of original insurance." Colonial Assurance Co. v. The Mercantile & Gen. Reinsurance Co., 297 F. Supp. 2d 764, 767 n.4 (E.D. Pa. 2003), citing Black's Law Dictionary 1287 (6th ed. 1990). In other words, reinsurance is insurance purchased by an insurer to protect itself against all adverse financial consequences of claims under its policies.

On this basis, those who support coverage for declaratory judgment expenses reject the notion that "duties owed the insured" is the template by which reinsurance coverage for loss and expense should be determined. Instead, the concept is that expenses incurred by a cedent to determine or avoid coverage under its policy (such as determining whether it is liable for a questionable claim) are within the proper scope of the reinsurers' obligations. Because many declaratory judgment actions are commenced by the insured and not at the insurer's discretion, from a cedent's perspective, declaratory judgment expenses represent dollars spent, which are no less fortuitous than the circumstances that gave rise to the original insured's claim, whether that claim turns out to be covered or not. The view here is that it is only natural for an insurer to expect reinsurance coverage for its extra-contractual expense exposure on the same basis that its contractual expense exposure is covered. To cedents, there is no economic difference between the two types of expenses.

For this reason, a typical cedent will take the view that a reinsurer's duty is multi-dimensional. First, the reinsurer is responsible under the reinsurance contract for losses and expenses that arise under the original insurance policy. In addition, the reinsurer is responsible (under the method set forth in the contract) for the cedent's claims-handling expenses – including declaratory judgment costs – that naturally flow from the need to adjust, determine and settle claims that arise from the issuance of an insurance policy.

Other arguments that may be raised include the following:

- > Cedents do not always make a black or white distinction between allocated loss adjustment expenses that are “contractual” or “extra-contractual.” Instead, allocated loss adjustment expenses are simply regarded as the costs that naturally flow from the claims-handling process. These costs are required to investigate the facts, make a coverage determination and settle with the insured and/or third party.
- > Cedents do not agree that declaratory judgment expenses can be properly characterized as “non-fortuitous,” “discretionary,” “general” or the result of faulty policy drafting as some reinsurers claim. Declaratory judgment actions are typically filed to determine coverage for an individual claim in the context of that claim's specific factual circumstances because most occurrence-based claims cannot be resolved in a factual vacuum. A declaratory judgment action may be the only means of obtaining all of the facts relating to the claim, which is frequently the case in coverage litigation dealing with arson or pollution, where discovery is critical in determining whether a loss was intentionally caused.
- > Cedents also believe it is a considerable over-simplification to attribute coverage disputes to their faulty policy drafting when, in fact, many declaratory judgment actions arise from questions of fact, borderline cases or unforeseen circumstances – which are inevitable in an industry such as insurance that sells a written product. Nor do insurers put much stock in the characterization of declaratory judgment expenses as discretionary losses. Most declaratory judgment suits are commenced by insureds, and even when the suit is initiated by the cedent, there frequently is no more prudent alternative. The point is that reinsurers' general characterizations of declaratory judgment expenses as discretionary loss are not considered by cedents as sufficient grounds for refusing to pay them.

Cedents responsible for any assumed reinsurance, especially that involving reinsurance markets that may also cede and/or retro-cede losses involving and/or including declaratory judgment expenses, may enjoy additional leverage in securing the recovery of declaratory judgment expenses. This stems from the obvious business considerations in the marketplace and the opportunity for quid pro quo. Nevertheless, these opportunities assume that the reinsurance market seeking the recovery of declaratory judgment expenses likewise possesses a reinsurance agreement that is silent and/or ambiguous in regards to the recovery of these costs.

#### **Equitable Arguments Favor Coverage**

Cedents dispute the reinsurers' position that legal liability arises solely from the terms of the underlying insurance policy and believe that such terms are merely a subset of a reinsurer's total obligation to its cedent. Reinsurance agreements are recognized as contracts in their own right which contain mutual covenants. Some obligations are expressed; some are inherent. Those that are inherent are said to derive from the contracting parties' reciprocal obligation of good faith. These cedents acknowledge a duty to exercise undiminished vigilance in the defense

and settlement of all claims tendered by the insured, notwithstanding the existence of reinsurance coverage. This vigilance is applied to the amount of settlements as well as to ensuring that losses tendered for coverage by the insured represent valid claims. This good faith duty will occasionally lead to a declaratory judgment action. From the cedent's point of view, the attendant expenses are incurred, in part, for the reinsurers' benefit. Accordingly, cedents consider it only fair for reinsurers, in return, to share in declaratory judgment expenses and take strong exception to the proposition that reinsurance begins and ends solely within the framework of the underlying policy. Instead, they argue that reinsurers obligations begin with the original policy obligations but surely do not end there.

A cedent's basic position, therefore, is that declaratory judgment expenses are inherently covered by their reinsurers because of the relationship of the parties. As such, a case can be made that if there is no exclusion of declaratory judgment expenses, they are inherently covered under the reinsurance contract.

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#### Contractual Language

Depending upon the exact language of the particular contract, an argument can be advanced on a broader front by reference to the contract wording. Generally, some type of expense-sharing provision is found in an excess of loss contract's "ultimate net loss" clause or in a pro rata contract's expense clause. Frequently, these wordings refer to the following as covered items: "expenses of litigation," "all other adjustment expenses of the company," "attorney's fees for claims in suit," etc. Unless there are restrictions on these terms such as "in the direct defense of claims against insureds" or "as provided under the original policy," they would seem to reflect an intention to cover all losses incurred by the cedent in response to an insured's claim, including declaratory judgment expenses.

One might also argue that declaratory judgment expenses are contemplated in an agreement if certain other coverages are provided. Consider an excess of loss contract that includes "Excess of Policy Limits" ("XPL") and Extra Contractual Obligations ("ECO") inclusive in the "ultimate net loss" definition. These types of coverages encourage aggressive handling of questionable claims. The cedent can pursue its coverage position knowing that its downside is protected, and that if a defense is successful, it will be rewarded rather than penalized by the expense-sharing arrangement of its reinsurance program. Indeed, cedents can cogently argue that declaratory judgment expense coverages would appear to be contemplated whenever ECO and XPL coverages are provided because a declaratory judgment action is a common method of defending against an insured's allegations of bad faith. It is arguably inconsistent for reinsurers that agree to share the consequences of ECO and/or XPL judgments to discourage cedents from putting up a determined defense to coverage by refusing to share declaratory judgment expenses.

Contractual terms such as loss settlements and indemnification clauses, which provide the cedent with unfettered discretion regarding matters of coverage and settlement of claims, might also be suggestive of a contractual intent to share declaratory judgment expenses. Contractual language such as this gives the cedent freedom of conduct and arguably, encourages the use of declaratory judgment actions when the cedent deems it necessary. An argument could easily be made that where a reinsured is given unfettered freedom to engage in declaratory judgment actions without a clear exclusion of the associated expenses, it is reasonable to conclude that coverage for these expenses was intended.

Some contracts also contain language that stops just short of specifically mentioning declaratory judgment actions. For example, some reinsurance contracts state: “the company shall commence and defend actions, suits or proceedings and do all things relating to any claim as in its judgment may be beneficial or expedient” or “reinsurers are liable for their share of expenses...contesting the validity of specific claims or losses or alleged losses.” Again, such language, in the absence of a clear, declaratory judgment expense exclusion, would provide a reasonable basis to conclude that declaratory judgment expenses are covered.

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#### A Reinsurer's Perspective

Reinsurers' reservations regarding the expenses associated with declaratory judgment actions stem from said actions in which the expenses frequently exceeded the indemnity limit(s) afforded and the action(s) encompassed more than one claim and/or involved general rather than specific issues and/or claims. Reinsurers argue that declaratory judgment actions can be extremely costly, occur unpredictably and are sometimes pursued at the cedent's sole discretion. Reinsurers that object to the discretionary nature of declaratory judgment expenses are uncomfortable with the exposure to a loss that may not be completely fortuitous. In a sense, when a declaratory judgment action is initiated by an insurer, a loss is incurred at the cedent's discretion. Thus, some reinsurers may take the position that declaratory judgment expenses are not covered by reinsurance contracts.

The argument that declaratory judgment expenses are not covered by reinsurers begins with a definition of “reinsurance” such as the following: “[A] contract whereby one for a consideration agrees to indemnify another wholly or partially against loss or liability by reason of a risk the latter has assumed under a separate and distinct contract as insurer of a third party.” Stickel v. Excess Ins. Co. of Am., 23 N.E.2d 839 (Ohio 1939). Under such a definition, the existence of the reinsurance liability is said to be totally dependent upon there being insurance liability under the original contract of insurance. In other words, the original policy circumscribes all that the reinsurer could conceivably be required to pay under the reinsurance contract – except where specifically agreed otherwise.

Broadly speaking, insurers have duties to indemnify and (in third-party cases) defend their insureds. Some of the expenses the insurer has a duty to pay are clearly spelled out in the original policy. Some other types of claim expenses arise as the insurer discharges its duties, e.g., expenses for things such as investigation, appraisal and travel of adjusters. These “loss adjustment expenses” generally present no problems to reinsurers because they arise in fulfillment of duties contractually owed to the insured.

Other arguments that may be raised include the following:

- > If the cedent wants coverage for any expenses beyond those provided for in the original policy, it must ask the reinsurer for coverage and obtain the reinsurer's agreement. The reinsurer is then able to charge additional premium for the exposure, and this is necessary because reinsurers operate under the basic assumption that reinsurance does not inherently involve any obligations that arise outside of the original policy. In other words, absent specific agreement, a reinsurer's liability begins and ends with the original policy.
- > Declaratory judgment expenses cannot reasonably be considered a subset of loss adjustment expense because they are so distinctly different in character from what is intended by the word “adjusting.” Costs associated with discharging duties to the insured cannot logically include the costs of resisting the insured's demand for coverage.

- > The “no coverage” argument concedes that a declaratory judgment action will sometimes confer a direct benefit on the reinsurers. Nevertheless, some reinsurers feel that the cedent has a good faith duty to take all reasonable action in response to a claim as if it had no reinsurance. The cedent is expected to perform whatever steps are prudent and necessary to ensure that reinsurers are billed only for valid claims. The reinsurer is responsible for nothing more than the loss and expenses arising from the underlying insurance policy unless the contract explicitly provides for the sharing of declaratory judgment expenses with the reinsurers.
- > Reinsurance contracts are “contracts of indemnity for liability” – which is another way of saying that reinsurance liability is wholly contingent on there being insurance liability, and expenses that do not arise from an obligation of the insurer to the insured cannot give rise to an obligation of the reinsurer absent specific agreement.
- > Some reinsurers do not view declaratory judgment expenses to be covered by a reinsurance agreement unless such coverage is specifically noted in the contract. If the contract is silent, declaratory judgment expenses are not covered by that agreement. Contractual support for this position appears in the form of the phrase “under the policy.” It is not unusual for these or similar words to appear somewhere within a reinsurance contract. For example, a reinsurance contract may provide that the “Reinsurers are reinsuring, to the amount herein provided, the obligations of the company under any original insurance.” This language is cited as evidence of the “contract of indemnity” principle mentioned above. In other words, reinsurers reinsure the obligations of the insurer under the original policy, and that is all – unless broader coverage is specifically agreed to by the parties.

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Arguments Specific to  
Certain Facultative  
Reinsurance Contracts

In the facultative market, there are a number of certificates in circulation that express the indemnity principle as follows. First, the reinsurance agreement provides that the liability of the reinsurer shall be subject in all respects to the terms and conditions of the original policy, except as otherwise specifically provided in the certificate. Then, language elsewhere in the certificate extends coverage to expenses that are not provided for in the original policy but fails to mention declaratory judgment expenses. Thus, some reinsurers would argue here that declaratory judgment expenses are “not covered” even though they are not the subject of an outright exclusion.

A claims cooperation clause may also operate to exclude declaratory judgment expenses if a cedent has failed to afford its reinsurers the opportunity to associate in the settlement of a particular claim. Unlike current practices in treaty reinsurance, most facultative certificates continue to include a claims cooperation clause, which reads along the lines of the following:

While the reinsurer does not undertake to investigate or defend claims or suits, the reinsurer, directly, or through its representative and/or counsel, shall nevertheless be given the opportunity to associate with the company and its representatives at the reinsurer’s expense in the defense of any claim, suit or proceeding that may involve this reinsurance with the full cooperation of the company...

The exact wording differs from certificate to certificate. Some quite clearly require the cedent to approach the reinsurer for its approval before any legal expenditures made by the cedent are binding on the reinsurer. Typically, facultative certificates also involve pro rata sharing of expenses based on the amount of loss. On this basis, when a declaratory judgment action successfully disposes of a claim that might otherwise have been a “loss,” the reinsurers have grounds to resist the cedent’s claim for reimbursement of the declaratory judgment costs because, nominally, these costs fall into the expense category and there was no “loss” to calculate the pro rata share of expenses against.

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Reported Case Law

Although arbitrators have been dealing with the reinsurance of declaratory judgment expenses for years, relatively few court cases have addressed the issue.

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US Law

The oldest reported US case addressing the issue is [Affiliated FM Insurance Co. v. Constitution Reinsurance Corp.](#), 416 Mass. 839, 626 N.E.2d 878 (Mass. 1994). In that case, an excess insurer sought a determination that under the terms of a facultative reinsurance certificate, the reinsurer was obligated to reimburse the insurer for legal expenses that the insurer had incurred in successfully defending itself against a declaratory judgment action brought by the insured. The trial court granted summary judgment in favor of the reinsurer – finding no reinsurance coverage for declaratory judgment expenses – and the cedent appealed.

Finding that there was no dispositive law addressing the issue, the appeals court focused on the certificate language, which stated:

Reinsurer shall pay its proportion of expenses [other than office expenses and payments to any salaried employee] incurred by the Company in the investigation and settlement of claims or suits and its proportion of court costs and interest on any judgment or award, in the ratio that the Reinsurer’s loss payment bears to the Company’s gross loss payment.

The court went on to find that the term “expenses” was ambiguous and thus permitted extrinsic evidence of trade usage, custom and practice to resolve the ambiguity. [Id.](#) at 845, 626 N.E.2d at 881-82. On remand, the jury found in favor of the ceding company and determined that declaratory judgment expenses were covered by the terms and conditions of the facultative reinsurance certificate.

Given that the court in [Affiliated FM](#) focused on the specific language in the contract, it is not surprising that a court construing different contract language would reach a different result. Finding no ambiguity under facultative reinsurance certificates, the United States Court of Appeals Second Circuit in [British International Insurance Co. v. Seguros La Republica, S.A.](#), 342 F.3d 78 (2d Cir. 2003), affirmed summary judgment in favor of the reinsurer holding that it was not liable for declaratory judgment expenses under the contracts. Unlike [Affiliated FM](#), the certificates at issue were silent with respect to “expenses.” Instead, each certificate stated only that: “This Certificate of Reinsurance is subject to the same risks, valuations, conditions, endorsements (except changes of location), assignments and adjustments as are or may be assumed, made or adopted by the reinsured, and loss, if any, hereunder is payable pro rata

with the reinsured and at the same time and place...” *Id.* at 80. Distinguishing Affiliated FM based on the specific contract language, e.g., “expenses” was defined in the Massachusetts case, the court held that the certificates “unambiguously limit reinsurance coverage to the risks specified in [the insurer’s] policies” and did not require the reinsurer to pay declaratory judgment expenses. *Id.* at 83.

It is important to note that although the Affiliated FM and British International courts reached different conclusions, they applied the same analytical process to resolve the issue. As the two cases show, US courts focus first and foremost on the specific contract language to determine whether there is an ambiguity. If there is no ambiguity, then US courts will decide the issue as a matter of law. If, however, an ambiguity is found, then US courts may allow extrinsic evidence to address the ambiguity. A court’s ruling as respects ambiguity or the lack thereof, however, does not dictate a specific result on the merits. In other words, finding that an ambiguity exists does not mean the cedent will prevail. Conversely, the absence of an ambiguity does not ensure judgment in the reinsurer’s favor.

Two federal district courts have held that unambiguous expense provisions in the reinsurance contracts at issue required the payment of declaratory judgment expenses. In Employers Reinsurance Corp. v. Mid-Continent Casualty Co., 358 F.3d 757 (10th Cir. 2004), the applicable contract language obligated the reinsurer to reimburse the ceding company’s “claims expenses,” which was defined to mean “all payment under the supplementary payment provisions of [the reinsured’s] policy, including court costs, interest upon judgments and allocated investigation, adjustment and legal expenses.” *Id.* at 762. This definition, based upon an incorporated supplementary payment provision, included “all expenses [the reinsured] incur[ed]” “with respect to any claim [the reinsured] investigate[d] or settle[d]”. *Id.* at 763. Finding in favor of the reinsured, the court held:

“claims expenses,” which include “all payments under the supplementary payment provisions of [the reinsured’s] policy,” thus covers [the reinsured’s] declaratory judgment attorney fees and expenses. [The reinsured] investigated the claims that formed the basis of the declaratory judgment actions. [The reinsured] incurred attorney fees and expenses with respect to those claims. Hence, the declaratory judgment attorney fees and expenses fall within the unambiguous language of the supplementary payment provisions. [The reinsurer] must reimburse [the reinsured] for those “claim expenses” at the contractually provided proportionate rate.

A similar result occurred in Employers Insurance Co. of Wausau v. American Re-Insurance Co., 256 F. Supp. 2d 923 (W.D. Wis. 2003). In that case, the reinsurance certificate at issue stated: “[t]he Reinsurer shall be liable for its portion of allocated loss expenses...” *Id.* at 924. The term “allocated loss expense” was defined to include “all expenses incurred in the investigation and settlement of claims or suits” – language the court held unambiguously “encompasses expenses incurred in declaratory judgment actions attempting to avoid coverage for a claim.” *Id.* at 925. Thus, the court found that there was “no question” that the reinsurer was obligated to pay declaratory judgment expenses.

Finally, in the most recent reported decision on the issue, a federal district court in California relied upon extrinsic evidence to interpret ambiguous contract language. In Fireman's Fund Insurance Co. v. General Reinsurance Corp., No. C-03-4406 JCS, 2005 WL 1865424 (N.D. Cal. Aug. 5, 2005), the five reinsurance certificates at issue obligated the reinsurer to pay its "proportion of expenses...incurred by [the ceding company] in the investigation and settlement of claims or suits."

Finding that the certificate language was "virtually identical to the language" in Affiliated FM, the court relied upon Affiliated FM and held that the term "expenses" was ambiguous. Id. For this reason, the court allowed extrinsic evidence to be introduced to determine the parties' intent in connection with the meaning of "expenses." The cedent then produced expert testimony in support of the coverage of declaratory judgment expenses, which the court deemed "highly credible." Based on such expert testimony and evidence that the reinsurer had routinely paid declaratory judgment expenses, the court determined that the reinsurer should pay its share of declaratory judgment expenses under the terms and conditions of the reinsurance agreements. Id.

Accordingly, to date, the reported US court decisions are four to one in the cedent's favor. These cases make it clear that the coverage of declaratory judgment expenses is wholly dependent on the reinsurance contract language at issue supplemented by extrinsic evidence when the language is found to be ambiguous. However, it is important to note that the reported case law is only part of the puzzle. Because most reinsurance disputes are decided in confidential arbitrations and those decisions never see the light of day, there are no doubt a number of decisions determining whether declaratory judgment expenses are covered that we cannot review or analyze. Thus, it is difficult to determine the extent to which arbitrators, who are generally not required to follow the strict rules of law, are influenced by case law. Indeed, given the varied background and experiences of individual panel members, it is likely that there will be disagreements with the case law and decisions will be based on industry knowledge, custom and practice. Parties and their counsel, however, are well advised not to ignore the case law regarding declaratory judgment expenses – particularly those decisions in which courts have undertaken a lengthy, detailed analysis of the issue.

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#### UK Law

There is little United Kingdom case law analyzing whether declaratory judgment expenses are recoverable under specific contract language. There are, however, UK cases that focus on whether coverage of declaratory judgment expenses should be implied where the contract is silent on the issue. For example, in Baker v. Black Sea & Baltic General Insurance Co., [1998] 2 All ER 833 (H.L.), the cedent argued that the essential characteristic of proportional reinsurance is the sharing of the same underwriting fortunes as the cedent, both as to risk and premium. Thus, the cedent argued that if it were to be liable for the whole of the costs of defending and settling claims by the insured, while receiving only a proportion of the premium, the nature of the bargain would be fundamentally altered. The House of Lords disagreed and refused to imply that declaratory judgment expenses were covered as a matter of law but did, however, remit the case to permit a hearing in connection with trade practice and usage.

Similarly, in Insurance Co. of Africa v. Scor, [1985] 1 Lloyd's Rep. 312, the reinsurer had informed the cedent that it would not pay indemnity if it chose to pay the insured's claim because the reinsurer regarded the claim as fraudulent. Consequently, the cedent was forced to deny liability to the insured, despite the fact that it did not possess any evidence of fraud. Subsequently, judgment was entered against the cedent and for the insured, with the cedent bearing the responsibility for the costs of the successful proceedings against it. The cedent made a claim for these costs against the reinsurer. Although the reinsurance contract was silent on the issue, the lower court awarded the cedent coverage for such costs because the reinsurer had forced the cedent to incur such legal expenses. On appeal, the lower court's decision was reversed because two of the three presiding law lords refused to imply coverage for declaratory judgment expenses.

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#### Custom and Practice

It is clear from the case law addressing whether reinsurance covers declaratory judgment expenses that custom and practice will likely play an integral part in answering the question. Fireman's Fund Insurance Co. v. General Reinsurance Corp., No-C-03-4406 JCS, 2005 WL 1865424 (N.D. Cal. Aug. 5, 2005), provides an analytical guideline on what evidence of custom and practice is needed to adequately support a finding in favor of such coverage. In Fireman's Fund, the late William J. Gilmartin proved to be the cedent's star witness and a key to the court's decision in favor of coverage. According to Mr. Gilmartin's testimony, between the 1960s and 1980s, reinsurers reimbursed cedents for payment of declaratory judgment expenses as a matter of custom and practice. Based on this testimony, and evidence that the reinsurer had routinely paid declaratory judgment expenses, the court found that at the time the subject certificates were issued there was a nearly universal custom and practice in the reinsurance industry of paying declaratory judgment expenses under certificates containing language substantially the same or similar to the language contained in the subject certificates.

The pivotal nature of Mr. Gilmartin's testimony was particularly significant because he was a witness for the losing side in British International Insurance Co. v. Seguros La Republica, S.A., 342 F.3d 78 (2d Cir. 2003). The Fireman's Fund court determined that the British International court had found Mr. Gilmartin's testimony to be "unpersuasive" for a number of reasons. First, Mr. Gilmartin did not aver that "reinsurers always and invariably" paid declaratory judgment expenses. Rather, his testimony could be interpreted as saying that declaratory judgment expenses "were made ex gratia when reinsurers believed that the coverage litigations advanced their common interest, but not otherwise." Fireman's Fund, 2005 WL 1865424. Second, in British International, Mr. Gilmartin failed to testify that "the language contained in the reinsurance certificates issued by other reinsurers was similar to the language in the certificates at issue in that case." Id. As such, it could not be said that a given practice or custom applied to the contractual language at issue. Third, in British International, there was "'no allegation of actual or constructive knowledge' on the part of the reinsurer or evidence that the practice was 'so notorious' in the industry that the reinsurer must have been aware of it." Id.

In Fireman's Fund, all of these deficiencies were overcome. The Fireman's Fund court found that Mr. Gilmartin's testimony could not "reasonably be read to say that reinsurers only paid DJ expenses when it suited their interests." Id. To the contrary, Mr. Gilmartin stated that "in all of his decades of experience in the reinsurance industry, he [was] unaware of a single instance in which a reinsurer denied DJ expenses to a cedent." Id. Likewise, Mr. Gilmartin "clearly stated that his opinion concerning the custom and practice of other reinsurers is based on his experience regarding the payment of DJ expenses under facultative reinsurance certificates containing the same or similar language to that at issue here." Id. Mr. Gilmartin's testimony, therefore, was purportedly based on his entire understanding of the entire reinsurance industry. Finally, the Fireman's Fund court found that "the evidence offered by Gilmartin that he never encountered a single instance in which DJ expenses were denied under similar language is sufficient to establish constructive knowledge based on a notorious custom and usage in the industry." Id.

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